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No. 95-325

In The
Supreme Court of the United States

October Term, 1995

UNITED STATES OF AMERICA,

Petitioner,

vs.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., *et al.*,

Respondents.

*On Petition for a Writ of Certiorari to the United States
Court of Appeals for the Tenth Circuit*

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Bankruptcy Code's priority for "an excise tax on a transaction occurring[.]" (11 U.S.C. § 507(a)(7)(E)(i)),¹ extends to a claim under 26 U.S.C. § 4971(a), labeled as a "tax" but imposed as a penalty for the non-occurrence of required pension plan contributions and not in compensation for any actual pecuniary loss to the Internal Revenue Service?

2. Whether such a claim, under the unique facts and circumstances of these liquidating Chapter 11 cases and the plan of reorganization, may be given a lower distributive priority than the claims of general unsecured creditors who suffered actual pecuniary losses, under (a) 11 U.S.C. § 510(c), or (b) 11 U.S.C. §§ 1122(a), 1123(a)(1), 1123(a)(4), 1129(a)(7), 1129(b)(1), and 502(j)?

1. Under the Bankruptcy Reform Act of 1994, the priority for certain excise tax claims has been moved from Section 507(a)(7)(E) to Section 507(a)(8)(E) of the Bankruptcy Code. Pub. L. No. 103-394, § 304(c), 108 Stat. 4106, 4132 (Oct. 22, 1994). That amendment does not affect this case and, for consistency, this brief cites the excise tax priority as 11 U.S.C. § 507(a)(7)(E).

RULE 29.1 STATEMENT

On November 7, 1990, the date of the petition for relief under Chapter 11 in Respondents' bankruptcy cases, CF&I Steel Corporation was a publicly owned corporation and was the sole owner of the stock of nine subsidiaries: CF&I Fabricators of Utah, Inc., Colorado & Utah Land Company, Kansas Metals Company, Albuquerque Metals Company, Pueblo Metals Company, Denver Metals Company, Pueblo Railroad Service Company, CF&I Fabricators of Colorado, Inc., and Colorado and Wyoming Railway Company.

On March 3, 1993, the effective date of the liquidating Chapter 11 plan confirmed by the bankruptcy court, all interests of stockholders were canceled, including the interests of CF&I Steel Corporation as sole stockholder of each of the other corporate debtors (Pet. 24a). Accordingly, Respondents are no longer "a corporation and nine wholly-owned subsidiaries" as the petition for a writ of certiorari states (Pet. 2). Respondents are ten separate corporate shells without stockholders, officers, or directors and are governed by Scott C. King, a representative of creditors appointed by the bankruptcy court (Pet. 36a). Under agreements with asset purchasers, "Reorganized" was added to six of the debtors' former corporate names (in the court of appeals the parties incorrectly identified each name as including the word "Reorganized"). Respondents' correct names are: Reorganized CF&I Fabricators of Utah, Inc., Colorado & Utah Land Company, Kansas Metals Company, Albuquerque Metals Company, Reorganized Pueblo Metals Company, Denver Metals Company, Reorganized Pueblo Railroad Service Company, Reorganized CF&I Fabricators of Colorado, Inc., Reorganized CF&I Steel Corporation, and The Reorganized Colorado & Wyoming Railway Company.

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RESPONDENTS' BRIEF IN OPPOSITION

Respondents, Reorganized CF&I Fabricators of Utah, Inc., Colorado & Utah Land Company, Kansas Metals Company, Albuquerque Metals Company, Reorganized Pueblo Metals Company, Reorganized Pueblo Railroad Service Company, Denver Metals Company, Reorganized CF&I Fabricators of Colorado, Inc., Reorganized CF&I Steel Corporation, and The Reorganized Colorado and Wyoming Railway Company (the "Reorganized Debtors"), respectfully request that this Court deny the petition of the United States for a writ of certiorari (the "Petition") to review a judgment of the United States Court of

Appeals for the Tenth Circuit in this case. The opinion below is reported at 53 F.3d 1155. As discussed below, this case involves matters which were correctly decided in the lower courts and do not present "special and important reasons" which warrant granting certiorari. S. Ct. R. 10.1.

STATUTES INVOLVED

The statutes involved are 11 U.S.C. §§ 507(a)(7)(E)(i), 510(c), 1122(a), 1123(a)(1), 1123(a)(4), 1129(a)(7), 1129(b)(1), and 502(j), and 26 U.S.C. § 4971(a). The relevant portions of these statutes are set forth in Respondents' Appendix ("Resp. App."), *infra*, at 7a-14a.

STATEMENT OF THE CASE

The Reorganized Debtors are ten bankrupt corporations liquidating their assets for the benefit of creditors under a Chapter 11 plan of reorganization (the "Plan of Reorganization") (Pet. 22a-37a).² Proceeds of the liquidation have been and will be distributed to creditors under the direction of a representative of creditors appointed by the bankruptcy court (*id.*). Because the Reorganized Debtors are deeply insolvent, general unsecured creditors who suffered hundreds of millions of dollars in actual pecuniary losses will be paid only a small percentage of their claims. The interests of former stockholders have been canceled and stockholders will receive nothing (Resp. App. 3a-4a).

The Reorganized Debtors' predecessor corporations filed bankruptcy because they could not fund two pension plans.³ Their largest creditor is the Pension Benefit Guaranty

2. Chapter 11 of the Bankruptcy Code expressly authorizes liquidating plans. 11 U.S.C. § 1123(a)(5)(D).

3. The bankruptcy court found that the debtors had a multitude of
(Cont'd)

Corporation (the "PBGC"), which took over the larger of two underfunded pension plans and as a result holds a general unsecured claim of over \$220 million (subject to possible reduction depending on the outcome of pending litigation concerning the discount rate to be used to calculate the claim).⁴

The IRS's claim at issue here is a 10% penalty imposed under 26 U.S.C. § 4971 ("Section 4971") because the Reorganized Debtors' predecessor corporations failed timely to make a pension plan funding payment that came due before they filed bankruptcy. Section 4971 imposes 10% and 100% penalties for failure to meet pension minimum funding obligations (Resp. App. 13a-14a). The IRS sought priority payment as "excise taxes" of both 10% and 100% penalties (multiplied for each succeeding year of underfunding) in excess of \$40 million (Pet. 45a).⁵ Except for the smallest penalty, *i.e.*, a 10% penalty for the first year, the IRS has abandoned all of its other 10% and 100% penalty claims, even though its argument for "excise tax" priority for those claims was exactly the same as its argument for "excise

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financial problems in addition to the claims of the Internal Revenue Service (the "IRS") and did not file bankruptcy solely to deal with the IRS's claims or to avoid payment of tax penalties (Resp. App. 3a, 4a-5a).

4. *Pension Benefit Guaranty Corporation v. Reorganized CF&I Fabricators of Utah Inc. (In re CF&I Fabricators of Utah, Inc.)*, 179 B.R. 704 (D. Utah 1994). The Plan of Reorganization provided for the full funding of the other, smaller pension plan. Under provisions of the Plan of Reorganization not appealed by the IRS, all claims relating to that plan, including the IRS's penalty claims of some \$36,577 (Pet. 44a), are deemed satisfied and are no longer at issue.

5. The Section 4971 penalties for the second year would be 20% and 200%, respectively, and so on, year after year (Pet. 45a). They were assessed in addition to the PBGC's claim for the missed minimum funding payments that is included as part of its \$220 million general unsecured claim.

tax" priority for the single 10% penalty claim asserted here. This relieves the IRS from having to argue that the 100% penalty claims are entitled to recovery and priority as "excise taxes."

The IRS suffered no pecuniary loss from the missed payments because the purpose of Section 4971 is not to raise revenue but to encourage pension funding.⁶ The PBGC, not the United States Treasury, will fund shortfalls in the underfunded pension plan (Pet. 3 n.4). On November 25, 1992, the bankruptcy court denied priority to the IRS's penalty claims (Pet. 38a-62a, published as *In re CF&I Fabricators of Utah, Inc.*, 148 B.R. 332 (Bankr. D. Utah 1992)).

The debtors proposed, in the Plan of Reorganization, to go out of business, liquidate their assets, and distribute the proceeds to creditors. A Chapter 11 plan must designate classes of claims "subject to section 1122" of the Bankruptcy Code. 11 U.S.C. § 1123(a)(1). A class of claims may include only claims that are "substantially similar." 11 U.S.C. § 1122(a).

Accordingly, the Plan of Reorganization created a class of general unsecured claims consisting entirely of claims for actual pecuniary losses (such as the PBGC's claim) and a separate class for penalties not in compensation for actual pecuniary losses (including the IRS's penalty claims). The bankruptcy court found that the Plan of Reorganization complied with the classification requirements of 11 U.S.C. § 1123(a) (Pet. 27a).

Since the Plan of Reorganization will not pay holders of general unsecured claims in full, any payment to the IRS for its

6. The lower courts found that the IRS's claims are not for any pecuniary loss (Pet. 6a, 18a, 47a, 52a, 62a; Resp. App. 3a) and the IRS has not questioned that determination. The IRS formerly asserted, and the courts below denied (Pet. 4a, 9a, 62a), priority under Section 507(a)(7)(G) (now codified at 11 U.S.C. § 507(a)(8)(G)) (penalty in compensation for actual pecuniary loss).

penalty claims would reduce, dollar for dollar, distributions to holders of general unsecured claims who suffered pecuniary losses, principally the PBGC as the largest creditor and, consequently, retirees covered by the pension plan. These are the very parties intended to be protected by statutes requiring pension funding such as Section 4971.⁷ The Plan of Reorganization therefore gave the IRS's penalty claims a lower distributive priority than that given to the general unsecured claims of the PBGC and other creditors who suffered actual pecuniary losses.

The bankruptcy court found that allowing the IRS the same distributive priority as the PBGC and other general unsecured creditors would advance neither the legislative purpose of Section 4971 nor the principle of equality of distribution that underlies the Bankruptcy Code. Instead it would punish creditors, principally the PBGC (Resp. App. 4a).⁸

Under 11 U.S.C. § 1129(a)(7)(A)(ii), the bankruptcy court

7. Payments to the PBGC in this case will in part reimburse the PBGC and in part go to retirees to pay retirement benefits not covered by the PBGC's guaranty limits. By contrast, any payments to the IRS on its penalty claims would be added to general revenues in the United States Treasury and would not be paid to the PBGC, the pension plan, or retirees. 26 U.S.C. § 7809.

8. Cf. *Simonson v. Granquist*, 369 U.S. 38, 40-41 (1962) ("[T]he prohibition of all tax penalties in bankruptcy [under former law] is wholly consistent with the policy of the penalty provisions themselves. Tax penalties are imposed at least in part as punitive measures against persons who have been guilty of some default or wrong. Enforcement of penalties against the estates of bankrupts, however, would serve not to punish the delinquent taxpayers, but rather their entirely innocent creditors."); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another."); *Sampsel v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941) ("[T]he theme of the Bankruptcy Act is equality of distribution.").

was required to find that impaired creditors would receive at least as much under the Plan of Reorganization as they would receive if the debtors were liquidated under Chapter 7. In contrast to Chapter 11 cases where non-consensual subordination of claims requires a court order, non-pecuniary loss penalties are automatically subordinated in Chapter 7 cases. 11 U.S.C. § 726(a)(4). In the particular circumstances of the debtors' Chapter 11 cases (which, as the bankruptcy court found, parallel those of a Chapter 7 case and warrant subordination of the IRS's non-pecuniary loss penalties (Resp. App. 3a-5a)), the Plan of Reorganization subordinated the IRS's penalty claims by giving them a lower distributive priority than the claims of creditors who suffered actual pecuniary losses. The Bankruptcy Court found that the Plan of Reorganization satisfied the requirements of 11 U.S.C. § 1129(a)(7) (Pet. 28a).

The bankruptcy court approved the Plan of Reorganization, finding among other things that the Plan of Reorganization was proposed in good faith and in compliance with the Bankruptcy Code (Pet. 27a) and that as to impaired classes of claims that did not accept the Plan of Reorganization (such as the class that included the IRS's penalty claims) the Plan of Reorganization did not "discriminate unfairly" and was "fair and equitable" as required by 11 U.S.C. § 1129(b)(1) (Pet. 28a).

The bankruptcy court also granted the debtors' summary judgment motion in their adversary proceeding to subordinate, pursuant to 11 U.S.C. § 510(c), the IRS's non-pecuniary loss penalty claims to the claims of general unsecured creditors who suffered pecuniary losses (Pet. 20a-21a). The bankruptcy court found that under the "unique facts presented in this case" the IRS's non-pecuniary loss claims properly should be subordinated to the claims of creditors who suffered pecuniary losses (Resp. App. 5a). The lower courts therefore did not subordinate the IRS's penalty claims based on "beliefs" or vague notions of

fairness as the Petition suggests (Pet. 9 n.6, 12, 18) but rather subordinated the claims based on detailed factual findings.

The bankruptcy court's order expressly incorporated findings made at the hearing on subordination (Pet. 20a). The Petition omits specific factual findings, summarized below, of the unique facts in this case that justify subordination of the IRS's penalty claims: The debtors did not file bankruptcy to avoid payment of IRS penalties and had a multitude of other financial problems. These Chapter 11 cases do not involve a reorganization of a continuing business. The Plan of Reorganization is a liquidation of assets of insolvent debtors, proposed after a two-year consideration of other options. Creditors who suffered actual pecuniary losses will be paid only a small portion of their claims and stockholders, whose shares have been canceled, will receive nothing. The IRS's claim is a penalty intended to punish the debtors which, if paid on these facts, would divert funds from and thereby punish the very creditors (*i.e.*, the PBGC and retirees) intended to be protected by pension funding requirements. Such payment would defeat the purpose of the statute that created the penalty. This case involves penalties that are not in compensation for any pecuniary loss to the IRS. If paid, the penalties would be paid by creditors who did suffer a pecuniary loss and had nothing to do with the missed payments, defeating the purpose of the bankruptcy laws to foster an equitable distribution. The bankruptcy court's findings are set forth in full in Respondents' Appendix at 1a-6a.

The district court and court of appeals affirmed the bankruptcy court's orders (Pet. 10a-11a, 1a-9a). The IRS sought, but was denied, a stay pending appeal (Pet. 14a). In a separate proceeding in these bankruptcy cases, the district court found that the Plan of Reorganization has been substantially consummated and that challenges to the confirmation order have become moot, at least insofar as they seek to upset sales transactions and

property transfers that have taken place in reliance on the confirmation order. *United Mine Workers of America Combined Fund v. CF&I Fabricators of Utah, Inc. (In re CF&I Fabricators of Utah, Inc.)*, 169 B.R. 984 (D. Utah 1994).

REASONS FOR DENYING THE WRIT

This case does not present special and important reasons which warrant granting certiorari. There is no constitutional question, no conflict with this Court's decisions, and no error in statutory interpretation or application. Any apparent conflict between the Tenth and Sixth Circuits as to "excise tax" priority is insignificant because dispositive statutory language not analyzed by either court requires the same result reached by the court of appeals in this case. This case does not present a conflict with any other court of appeals on the matter of subordinating a non-pecuniary loss penalty without priority. The unique facts of this case are not of substantial recurring importance and the court of appeals' decision on these facts does not significantly affect the administration of the bankruptcy laws.

I.

THE TENTH CIRCUIT'S DECISION PRESENTS NO CONSTITUTIONAL QUESTION, IS NOT IN CONFLICT WITH ANY DECISION OF THIS COURT, AND CORRECTLY DECIDES THE STATUTORY ISSUES.

A. Priority under Section 507(a)(7)(E).

This case does not involve any issues of constitutional law. It involves interpretation of the Bankruptcy Code.

This Court has not addressed the priority granted by 11 U.S.C. § 507(a)(7)(E) for excise taxes on transactions. The Tenth Circuit correctly denied the IRS its claimed priority under

Section 507(a)(7)(E), which grants priority to governmental claims "only to the extent that such claims are for . . . an excise tax (emphasis added)."

The words "only to the extent that" and the absence of any Bankruptcy Code definition of "excise tax" presuppose inquiry into the nature of claims alleging excise tax priority. Nothing in the Bankruptcy Code limits the principle established under former bankruptcy law that bankruptcy courts may inquire and decide whether governmental claims are entitled to bankruptcy priority as taxes, regardless of labels in non-bankruptcy statutes, state or federal. *See, e.g., City of New York v. Feiring*, 313 U.S. 283 (1941) (whether state "sales tax" was "tax" entitled to bankruptcy priority depended on its characteristics rather than its denomination); *United States v. State of New York*, 315 U.S. 510 (1942) (labels in the Social Security Act did not foreclose inquiry into whether claims were entitled to priority in bankruptcy as a tax).

Here the inquiry was not difficult because the IRS acknowledged that legislative history and legislative intent indicate that claims under 26 U.S.C. § 4971 are in reality penalties (Pet. 47a). The disputed issue before the bankruptcy court was, therefore, not the true nature of the exaction under Section 4971(a). The dispute in this case arose over the IRS's argument that its claims, 10%, 100%, and annual multiples thereof, were automatically, and without any inquiry into their nature, entitled to "excise tax" priority under the Bankruptcy Code solely because they arise under an Internal Revenue Code section that labels them a "tax" and because that section appears under a subtitle heading containing the words "excise taxes" even though to grant them such a priority would produce results directly at odds with both the Bankruptcy Code and Section 4971 (Pet. 49a-52a, Resp. App. 4a). The bankruptcy court, district court, and court of appeals correctly rejected the IRS's argument.

The decisions of the courts below in this case are consistent with the Bankruptcy Code's treatment of penalties, which receive priority only if they are "in compensation for actual pecuniary loss," 11 U.S.C. § 507(a)(7)(G) (now § 507(a)(8)(G)), or are incurred after bankruptcy by the bankruptcy estate, 11 U.S.C. § 503(b)(1)(C).

B. Equitable subordination.

This Court has not addressed subordination of non-pecuniary loss claims for statutory penalties under either 11 U.S.C. § 510(c) or other provisions of the Bankruptcy Code. Under former law, penalty claims such as the IRS's claim in this case were disallowed outright. 11 U.S.C. § 93j (repealed 1978); *Simonson v. Granquist*, 369 U.S. 38 (1962). Therefore, equitable subordination of such claims was never addressed under former law.

This Court's equitable subordination decisions in *Comstock v. Group of Institutional Investors*, 335 U.S. 211 (1948); *Pepper v. Litton*, 308 U.S. 295 (1939); and *Taylor v. Standard Gas & Electric Co.*, 306 U.S. 307 (1939) are distinguishable on their facts. Those cases involved issues concerning subordination of claims for actual pecuniary loss, not claims for penalties. The decision of the court of appeals in this case is therefore not inconsistent with those decisions.

Equitable subordination in *Pepper* and *Taylor* protected innocent creditors from harm by subordinating the claims of creditors who violated fiduciary obligations and mismanaged corporate affairs. Subordination of the IRS's claims in this case also protected innocent creditors from harm by refusing to punish them for the debtors' violation of ERISA (through failure to make a statutorily required payment).⁹ The Tenth Circuit's decision in

9. The IRS repeatedly asserts its own innocence (Pet. 12, 18, 20) but it
(Cont'd)

this case is not a departure from established precedent, but instead is a similar application of equitable principles to a situation which had not arisen under prior law because prior law disallowed federal non-pecuniary loss penalties entirely.¹⁰

The court of appeals' decision is faithful to the text of Section 510(c), which expressly permits subordination of claims "for purposes of distribution" based on "principles of equitable subordination." The decision in this case did not, as the IRS suggests, assume authority (Pet. 12, 18), but rather exercised a power explicitly granted by Congress in Section 510(c). The court of appeals correctly rejected the IRS's non-textual arguments for limits on Section 510(c). Despite the IRS's arguments, the text of Section 510(c) does not require a finding of inequitable conduct or freeze principles of equitable subordination in time by forever terminating the power of courts to make precedents in new circumstances (e.g., the subordination of penalties which formerly had been disallowed by statute).

(Cont'd)

suffered no loss and its attempt to take money from the PBGC and retirees, who suffered a huge loss, undermines that assertion.

10. "[T]here is an undeniable equity in the postulate that participation in the estate should be denied to a creditor who has neither in some degree contributed to the distributable funds . . . nor has suffered a pecuniary loss by parting with something in money's worth." 3 Collier on Bankruptcy ¶ 57.22[1] at 382 (14th ed. 1977) (discussing disallowance of penalties under former law).

II.

ANY APPARENT CONFLICT BETWEEN THE TENTH AND SIXTH CIRCUITS ON THE INTERPRETATION OF SECTION 507(a)(7)(E) IS NOT SIGNIFICANT BECAUSE DISPOSITIVE LANGUAGE OF SECTION 507(a)(7)(E) LIMITING THE EXCISE TAX PRIORITY IN BANKRUPTCY TO CASES INVOLVING A "TRANSACTION OCCURRING," AND REQUIRING THE SAME RESULT REACHED IN THE TENTH CIRCUIT, WAS NOT ANALYZED BY EITHER COURT OF APPEALS.

The IRS's claim is not based on a "transaction occurring" as required by the plain language of Section 507(a)(7)(E), but instead is based solely on the non-occurrence of a required pension plan contribution. 11 U.S.C. § 507(a)(7)(E). The IRS's argument for priority therefore lacks merit. The IRS ignores the plain language of Section 507(a)(7)(E) requiring that a governmental claim asserting "excise tax" priority arise on the basis of a "transaction occurring" and instead asserts an unqualified priority based on broad phrases in legislative materials (Pet. 13, 15, 16-17).

A decision by this Court on the arguments presented in the Petition would not resolve the dispositive issue of whether the statutory requirement of a "transaction occurring" is satisfied by a simple failure to fund a pension plan. That issue, although raised by the Reorganized Debtors in the court of appeals in this case, was not addressed by the court of appeals. The Sixth Circuit did not address this issue in *Mansfield* except to conclude, in a footnote without analysis, that the argument had no merit. *United States v. Mansfield Tire & Rubber Co.*, 942 F.2d 1055, 1059 at n.4 (6th Cir. 1991), *cert. denied sub nom. Krugliak v. United States*, 502 U.S. 1092 (1992). Further litigation in the courts of appeals should be permitted to address this dispositive issue.

III.

THERE IS NO CONFLICT IN THE COURTS OF APPEALS ON THE INTERPRETATION OF SECTION 510(c), AND THE PARTICULAR FACTUAL CIRCUMSTANCES OF THIS CASE PRESENT ALTERNATIVE STATUTORY GROUNDS FOR GRANTING THE IRS'S CLAIM A LOWER DISTRIBUTIVE PRIORITY.

Lower court rulings on the subordination of penalty claims in a case such as this are not in conflict. The courts of appeals are unanimous in agreement with the court of appeals in this case that, in the narrow context of non-pecuniary loss penalties, equitable subordination under 11 U.S.C. § 510(c) does not require a finding of inequitable conduct. *United States v. Noland*, 48 F.3d 210 (6th Cir. 1995), *petition for cert. filed*, 64 U.S.L.W. 3161 (U.S. Aug. 24, 1995) (No. 95-323); *Burden v. United States*, 917 F.2d 115 (3d Cir. 1990); *Schultz Broadway Inn v. United States*, 912 F.2d 230 (8th Cir. 1990); *In re Virtual Network Services Corp.*, 902 F.2d 1246 (7th Cir. 1990).

The decision of the court of appeals in this case does not, as the Petition incorrectly argues (Pet. 12, 21), broaden any perceived conflict among other courts of appeals on subordination of claims that qualify for a Section 507 priority. The court of appeals in this case first found that the IRS's claim was not entitled to priority under Section 507 and then addressed only subordination of the IRS's claim as a claim not entitled to priority under Section 507, stating that it "need not discuss" subordination of a claim entitled to Section 507 priority (Pet. 6a).

Under the particular facts of this case, the lower distributive priority given the IRS's claim is fully justified under statutes other than Section 510(c), including those governing a Chapter 11 plan, 11 U.S.C. §§ 1122(a), 1123(a)(1), 1123(a)(4),

1129(a)(7), and 1129(b)(1), and 11 U.S.C. § 502(j). Section 1122(a) requires a Chapter 11 plan to classify separately claims that are not "substantially similar." It is self-evident that claims for a pecuniary loss are not substantially similar to claims that do not represent a pecuniary loss. Section 1123(a)(1) requires that a Chapter 11 plan designate classes of claims. Section 1123(a)(4) requires that a Chapter 11 plan treat claims within a class equally. Section 1129(a)(7) requires a Chapter 11 plan to provide non-accepting impaired classes of claims at least as much as if the debtor were liquidated under Chapter 7.¹¹ Section 1129(b)(1) requires confirmation of an otherwise confirmable Chapter 11 plan that does not "discriminate unfairly" among classes of claims and is "fair and equitable."

In these statutes the Bankruptcy Code expressly authorizes bankruptcy courts to consider the circumstances of the case, including the nature of the claims involved and fairness and equity, in the context of the distributive priority of claims. Furthermore, Section 502(j) gives bankruptcy courts full equity powers to allow or disallow claims that previously have been allowed or disallowed "according to the equities of the case."¹² This Court, in *Pepper v. Litton*, 308 U.S. 295 (1939), held that the express power granted under Section 502(j)'s predecessor (Bankruptcy Act Section 57k, 11 U.S.C. § 93k (repealed 1978)) to reconsider claims based on the equities of the case implies that "disallowance or subordination in light of equitable considerations may originally be made." 308 U.S. at 305.

11. Chapter 7 automatically subordinates claims for penalties that "are not compensation for actual pecuniary loss suffered by the holder of such claim." 11 U.S.C. § 726(a)(4).

12. The IRS's claims were "deemed allowed" when filed, subject to objection. 11 U.S.C. § 502(a).

These separate statutes, as the Reorganized Debtors argued in the court of appeals, authorized the bankruptcy court to consider the equities of this case and grant the IRS's non-pecuniary loss penalty claim a lower distributive priority than that granted to the claims of creditors who suffered pecuniary losses. Therefore, this case is not a suitable case for determining the extent of "principles of equitable subordination" under Section 510(c). Neither the court of appeals below nor the Sixth Circuit in *Mansfield, supra*, analyzed these dispositive statutes other than Section 510(c).

IV.

THE QUESTIONS PRESENTED DO NOT SIGNIFICANTLY AFFECT THE ADMINISTRATION OF THE BANKRUPTCY LAWS AND ARE NOT OF SUBSTANTIAL, RECURRING IMPORTANCE.

While bankruptcy claims for excise tax priority in general may be litigated frequently, since the Bankruptcy Code became effective in 1979, the IRS's claim to priority for a Section 4971(a) penalty has only been addressed in two courts of appeals, the court below and the Sixth Circuit in *Mansfield, supra*. The bankruptcy court correctly found that this case presents unique facts for equitable subordination (Resp. App. 5a). These unusual circumstances are not of substantial, recurring importance.

REASONS FOR NOT REVIEWING THIS CASE IN TANDEM WITH *UNITED STATES V. NOLAND*

The issue presented in *United States v. Noland*, 48 F.3d 210 (6th Cir. 1995), *petition for cert. filed*, 64 U.S.L.W. 3161 (U.S. Aug. 24, 1995) (No. 95-323) is not "closely analogous" to the issues in this case as stated in the Petition (Pet. (I)). In *Noland*, the court subordinated a penalty claim for unpaid *post-*

bankruptcy social security and unemployment taxes that had priority under Bankruptcy Code Section 503(b)(1)(C) (giving priority to post-bankruptcy penalties). In this case, the primary issue is whether the IRS's *pre-bankruptcy* penalty claim, under a different statute, for failing to make a pension funding payment, has statutory priority at all under Bankruptcy Code Section 507(a)(7)(E) which limits priority to an "excise tax on a transaction occurring."

Once the courts below determined that the IRS's claim is a general unsecured claim without statutory priority, the subordination in this case did not raise unusual legal issues. Furthermore, the lower distributive priority given to the IRS's claim in this case was fully justified under statutes governing Chapter 11 plans, none of which apply in *Noland*, a Chapter 7 case. Neither an affirmance nor a reversal of the *Noland* decision by this Court should have an effect on the outcome in this case.

REASONS FOR LIMITING REVIEW IF THE PETITION IS GRANTED

If the Court grants the Petition, review of the order confirming the Plan of Reorganization should be limited to the distributive priority of the IRS's claim and should exclude any other matter pertaining to the confirmation order. Insofar as the Petition may seek total reversal of the order confirming the Plan of Reorganization (and reversal of multi-million dollar property sales and payments that have taken place in reliance on the confirmation order), that challenge to the confirmation order has become moot, as the district court has found in another proceeding in the Reorganized Debtors' bankruptcy cases. *United Mine Workers of America Combined Fund v. CF&I Fabricators of Utah, Inc.* (In re *CF&I Fabricators of Utah, Inc.*), 169 B.R. 984 (D. Utah 1994). The IRS can obtain full relief as to its penalty claim (*i.e.*, priority as an excise tax or a general

unsecured claim) if review is limited to the matters of distributive priority argued in the Petition. The Plan of Reorganization as confirmed provides for full payment of priority tax claims and provides that if non-priority penalty claims are not subordinated they will be treated along with other general unsecured claims.

CONCLUSION

The Court should deny the Petition.

Respectfully submitted,

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**APPENDIX A — TRANSCRIPT OF THE UNITED STATES
BANKRUPTCY COURT FOR THE DISTRICT OF UTAH,
CENTRAL DIVISION DATED JANUARY 28, 1993**

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION**

Bankruptcy No. 90B-06721

Chapter 11

In re:

CF&I FABRICATORS OF UTAH, INC.,

DEBTOR.

BEFORE THE HONORABLE JUDITH A BOULDEN

January 28, 1993

APPEARANCES OF COUNSEL:

For the Debtor:	Steven C. Strong Attorney at Law 136 South Main Street Salt Lake City, Utah
For the Unsecured Creditors Committee:	Steven T. Waterman Attorney at Law 79 South Main Street Salt Lake City, Utah
For the IRS:	Mark Howard Attorney at Law 125 South State Street Salt Lake City, Utah

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[3] Salt Lake City, Utah January 28, 1993

THE CLERK: This is in the matter of CF&I Fabricators of Utah.

THE COURT: Counsel, state your appearances.

MR. WATERMAN: Steven T. Waterman, of Ray, Quinney and Nebeker, appearing on behalf of the Unsecured Creditors' Committee.

MR. STRONG: Steven C. Strong, of LeBoeuf, Lamb Leiby and MacRae, appearing on behalf of the debtors.

MR. HOWARD: Mark Howard, Special Assistant United States Attorney, appearing for the Internal Revenue Service.

THE COURT: Counsel, the matter that is before the Court today is the debtor's motion for summary judgment in the adversary proceeding filed against the Internal Revenue Service. I had indicated last night on the record that I would enter a ruling on the record today. If there are comments or further argument that the parties wish to make at this point, I'm certainly willing to entertain it.

MR. WATERMAN: I would just indicate, Your Honor, that the order granting the Unsecured Creditors' Committee intervention was just signed. We have not filed anything, but I think Your Honor understands that we do support the position of the plaintiff.

THE COURT: All right. Is there anything further then? All right. Initially let me indicate that this is a [4] core matter. It is one

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that arises in and relates to CF&I's bankruptcy case and claims that have been filed against the debtor. In this adversary proceeding the debtor requests that the claims filed by the Internal Revenue Service for non pecuniary loss penalties be equitably subordinated to the claims of the general unsecured creditors pursuant to section 510(C) of the code. After review of the pleadings submitted by both parties, and now as indicated by Mr. Waterman also, and the representations of counsel, I'll find that there is no genuine issue of fact that is material to this litigation that is disputed, and I will also find that the debtors are entitled to summary judgment as a matter of law. Even though there are no uncontested disputed facts, let me indicate for the record the factual circumstances that I'm basing the ruling on.

The debtors have been under the jurisdiction of the Court in Chapter 11 for over two years. The debtors are insolvent. The debtors have a multitude of financial problems in addition to the claims of the Internal Revenue Service. And the filing arises not solely to deal with the Internal Revenue claims. The debtors have proposed and have now confirmed a liquidating plan that pays only a small portion of unsecured claims and does not return any amount to equity interest holders. The Internal Revenue Service's claim is for non pecuniary loss penalties as a result of the [5] debtors failure to pay minimum funding requirements to its two pension plans. Any payment to the Internal Revenue Service on these claims would reduce the payment to general unsecured claims, including the PBGC. And I'll also find — make a finding that there has been no inequitable conduct on the part of the Internal Revenue Service.

As section 510(C) applies to the facts of this case, it is appropriate to equitably subordinate the Internal Revenue Service penalty claims to the claims of unsecured creditors,

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including the unsecured claims of the PBGC. Unsecured claimants will receive only a small percentage of their total claims, and equity interest holders are receiving no distribution. Allowing the substantial Internal Revenue penalty claims to participate as a general unsecured claim will effectively reduce the PBGC's recovery on the unsecured portion of its claim for the pension plan, underfunding the very claims upon which the Internal Revenue Service assesses. Section 49-71 penalties allowing the Internal Revenue Service to share in the distribution to unsecured creditors on the same basis as the pecuniary loss claims of the PBGC does not advance the legislative purpose of section 49-71 of the Internal Revenue Code or the general principal of fair sharing among creditors advanced by the Bankruptcy Code. Instead, it punishes creditors of the debtors rather than punishing the debtors.

[6] Contrary to the assertion of the Internal Revenue Service that equitable subordination under section 510(C) requires a showing of inequitable behavior on behalf of the creditor, I reach the conclusion that the section 49-71 penalty should be subordinated, whether or not the taxing authority engaged in any misconduct.

In this case, as I indicated, I find no showing of inequitable conduct on the part of the Internal Revenue Service or that there is any need for such showing under the circumstances of this case. The IRS asserts that subordination of tax penalties is relegated to Chapter 7, absent a showing of misconduct. In this case, where the debtors propose a liquidating Chapter 11 case with no distribution to equity interest holders and only partial payment to unsecured creditors, the treatment for non pecuniary loss penalties should not be different than that under a Chapter 7 proceeding. Although this case resulted in liquidation, the

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debtors filed for reorganization to accomplish several other purposes other than avoiding payment of tax penalties. After nearly two years of serious consideration of a variety of options, the debtors concluded that a sale of substantially all of the estate assets to a single buyer was the only feasible method of rehabilitation.

Based upon the unique facts presented in this case, and in the absence of any genuine issue of material fact, the [7] judgment in favor of the debtors is granted on all causes of action contained in the complaint. Mr. Strong, would you prepare judgment to that effect?

MR. STRONG: Yes.

THE COURT: Is there anything further? Thank you.

MR. HOWARD: Your Honor, I presume from what you have stated on the record that the confirmation order was entered last night then? I did not stay for the entire hearing. There were additional matters going on on other claims.

THE COURT: Counsel, I did not execute a confirmation order last night. I did confirm the plan, ruled on a number of other issues, made findings of fact and conclusions of law on the record. Mr. McCardell indicated that they had a number of other orders that he needed entered in addition to a ruling under Section 1129 that he needed in order to effectuate consummation of the plan of reorganization. He indicated those on the record. There were no objections to entering them. Some of the issues had to do about whether or not Oregon Steel was a good faith purchaser. Those kinds of things. He indicated that he would draft the order of confirmation and the ancillary orders and would circulate them

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to the individuals that were indicated on the roster. And after the time had passed for objection to the form of the order, then I'll execute it. [8] So, in answer to your question, I confirmed the plan, but there was no order executed yesterday. So the appeal time has not yet started to run.

MR. HOWARD: Thank you.

THE COURT: Is there anything further? We'll be in recess.

(Recess.)

APPENDIX B — RELEVANT STATUTES

Bankruptcy Code (11 U.S.C.) (the Bankruptcy Code was amended by Pub. L. No. 103-394, 108 Stat. 4106 (Oct. 22, 1994), but because those amendments do not affect this case the pre-amendment version of each applicable statute is given below):

§ 502. Allowance of claims or interests

* * *

(j) A claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim may be allowed or disallowed according to the equities of the case. Reconsideration of a claim under this subsection does not affect the validity of any payment or transfer from the estate made to a holder of an allowed claim on account of such allowed claim that is not reconsidered, but if a reconsidered claim is allowed and is of the same class as such holder's claim, such holder may not receive any additional payment or transfer from the estate on account of such holder's allowed claim until the holder of such reconsidered and allowed claim receives payment on account of such claim proportionate in value to that already received by such other holder. This subsection does not alter or modify the trustee's right to recover from a creditor any excess payment or transfer made to such creditor.

*Appendix B***§ 507. Priorities**

(a) The following expenses and claims have priority in the following order:

* * *

(7) Seventh, allowed unsecured claims of governmental units; only to the extent that such claims are for —

* * *

(E) an excise tax on —

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

* * *

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(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

* * *

§ 510. Subordination

* * *

(c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may —

(1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or

(2) order that any lien security such a subordinated claim be transferred to the estate.

§ 1122. Classification of claims or interests

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other

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claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

§ 1123. Contents of plan

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall —

(1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a)(1), 507(a)(2), or 507(a)(7) of this title, and classes of interests;

* * *

(4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

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* * *

(7) With respect to each impaired class of claims or interests —

(A) each holder of a claim or interest of such class —

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in

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the property that secures such claims.

* * *

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

Internal Revenue Code (26 U.S.C.):

§ 412. Minimum Funding Standards.

(a) **General Rule.** — Except as provided in subsection (h), this section applies to a plan if, for any plan year beginning on or after the effective date of this section for such plan —

(1) such plan included a trust which qualified (or was determined by the Secretary to have qualified) under section 401(a), or

(2) such plan satisfied (or was determined by the Secretary to have

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satisfied) the requirements of section 403(a).

A plan to which this section applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year, the plan does not have an accumulated funding deficiency. For purposes of this section and section 4971, the term "accumulated funding deficiency" means for any plan the excess of the total charges to the funding standard account for all plan years (beginning with the first plan year to which this section applies) over the total credits to such account for such years or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years. In any plan year in which a multiemployer plan is in reorganization the accumulated funding deficiency of the plan shall be determined under section 418B.

§ 4971. Taxes on Failure to Meet Minimum Funding Standards.

(a) **Initial Tax.** — For each taxable year of an employer who maintains a plan to which section 412 applies, there is hereby imposed a tax of 10 percent (5 percent in the case of a multiemployer plan) on the amount of the accumulated funding deficiency under the

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plan, determined as of the end of the plan year ending with or within such taxable year.

(b) Additional Tax. — In any case in which an initial tax is imposed by subsection (a) on an accumulated funding deficiency and such accumulated funding deficiency is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of such accumulated funding deficiency to the extent not corrected.

(c) Definitions. — For purposes of this section —

(1) Accumulated funding deficiency — The term “accumulated funding deficiency” has the meaning given to such term by the last two sentences of section 412(a).